HISTORY OF BANK INDONESIA : MONETARY
Period from 1999-2005

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1. Highlights

During this period, the Indonesian economy began to improve; thanks to numerous positive contributing factors. These factors include international economic outlook which was quite favorable, institutionalization of domestic socio-politics, especially under Megawati's administration, which proved conducive as well as stable monetary condition. The improving Indonesian economy from 1999 was attributed to the government's general policies coupled with BI's monetary policies.

During this reform era, the government adopted a tight monetary policy to absorb the excessive liquidity as to sustain the pressure against inflation and rupiah exchange rate. This policy was carried out through the open market operation (OPT), rupiah intervention in the rupiah money market and sterilization of the foreign exchange market. By virtue of Act No. 23 of 1999, Bank Indonesia had to set the country's inflation rate as the basis for planning and control the monetary goal. But this was restricted to the inflation which could be influenced by the monetary policy called as the Core Inflation. Act No. 24 of 2000 regarding foreign exchange traffic and conversion rates has virtually introduced the free foreign exchange regime. BI was in charge of the monitoring and reporting of foreign exchange traffic activities performed by banks and non-bank financial institutions (LKBB). This provision took effect as from 28 April 2000 for banks and 28 March 2002 for non-bank financial institutions.

In this period, the government managed to reschedule the offshore loan repayments and officially ended its cooperation with IMF. To reduce Indonesia's offshore loan repayment burden, pursuant to the 2nd Paris Club meeting, on 13 April 2000 the government and the lenders agreed the rescheduling of the country's offshore loan repayments. Meanwhile, Indonesia's cooperation with IMF in the rehabilitation and reform program would expire in the end of 2003. By then, Indonesia's borrowing position to IMF in the end of 2002 became USD 8.9 billion. As the cooperation with IMF would end on 22 April 2002, the government set up the Team to Study the Post-Cooperation with IMF. The team came up with four options to the Government. From these four options, the government approved the second option, namely Post Program Monitoring (PPM) with IMF

2. Focus Of Policies 1999-2005

Having learned from the economic crisis that had occurred from the previous period, the general policies of the Government and the monetary policies of Bank Indonesia were focused on strengthening the macroeconomic foundation, among others through the monetary and financial stabilization to ensure a sustainable economic growth.

Having learned from the economic crisis that had occurred from the previous period, the general policies of the Government and the monetary policies of Bank Indonesia were focused on strengthening the macroeconomic foundation, among others through the monetary and financial stabilization to ensure a sustainable economic growth. The main target was low and steady prices and monetary control during this period. As BI became an independent institution at the beginning of this period, the monetary stability achieved in this period would differ from that in the previous periods.

In correspond to the post-crisis economic condition characterized with the steep prices, rupiah low exchange rate and poor competitiveness, the short-term monetary policies were more directed to ease such pressures. This would be achieved through the following main strategies: tight liquidity, exchange rate stabilization, maintenance of adequate foreign exchange reserves and financial system stabilization.

3. Strategic Steps 1999-2005

The main strategic steps of the monetary policies of this period were focused on a single goal, namely to achieve and maintain rupiah steady value against goods and prices (inflation) and against foreign currencies (exchange rate).

The main strategic steps of the monetary policies of this period were focused on a single goal, namely to achieve and maintain rupiah steady value against goods and prices (inflation) and against foreign currencies (exchange rate). Under such circumstance, the rupiah exchange rate is not regulated or directed by Bank Indonesia but is determined by the market supply and demand, although it remains being calculated in the achievement of the monetary policy' final goal, namely low inflation rate.

To achieve the final goal, BI periodically monitors the development of numerous real economic variables such as consumption, investment, export-import, and the entire economic sectors. In addition, BI also monitors the mechanism effectiveness of closely watches the policy transmission towards the real sectors which generally takes place via a number of channels, such as:

1) money channel,
2) credit channel,
3) interest rate channel,
4) exchange rate channel, asset price channel,
5) expectation channel.

In line its independence from 1999, BI is now free to make monetary policies in compliance to the inflation target as projected by the Government. In spite of this, BI had to transparently notify such policies to the House of Representatives and the Government as a proof BI's accountability to the public.

4. Foreign Exchange Policies in Indonesia 1999-2005

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In this period, BI was responsible for monitoring and obligating the banks, non-bank financial institutions and non-financial institution firms inform their traffic of foreign exchange. Such duties were contained in Act No. 24 of 1999 dated 17 May 1999 regarding the Traffic of Foreign Exchange and Exchange Rate System.

Such notifications were essential as within the open economy as adopted by Indonesia, the monetary development is heavily influenced by the traffic of foreign exchange.

Such reporting system was not aimed at revising the adopted foreign exchange system, namely free foreign exchange system. This system was maintained in this period because Indonesia badly needed foreign funds to supplement the development financing and to cover the immense current transaction deficit.

5. Exchange Rate Policies in Indonesia 1999-2005

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6. Foreign Debt Policies 1999-2005

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The offshore loan policies during this period was more focused on the efforts to improve the current transaction performance, balance of payment and state finance, and on how to minimize the debt service ratio (DSR) sot that it hovered on the level considered safe by the World Bank. Such measure was necessary because the amount of the Government's debt in this period was nearly equal to the country's GDP, or sharply rose compared to that in the pre-crisis period, which was 35% of GDP in 1996. At the end of December 2001, the Government's offshore loans reached USD 71.4 billion or 49.1% of the GDP of 2001. As the offshore loans by the private sector reached USD 59.8 billion in 2001, Indonesia's total borrowings reached USD 131.2 billion or 90.3% of the country's GDP of 2001. It was estimated that Indonesia's debt service ratio (DSR) in 2001 and 2002 was respectively 39.4% and 34.9%. These were far higher than the level considered safe by the World Bank, namely 20%.

In a bid to ease the burden to repay such offshore loans, in 2000 the Government convened Paris Club II meeting on 12 and 13 April in Paris. The meeting decided to reschedule the installments of the principle borrowings for the payable that matured on 31 March 2002 until 31 March 2002. This rescheduling applied to the soft loans (Official Development Assistance/ODA) and non-soft loans. In addition, in September 2000, the forum managed to reschedule the repayment of principle commercial loans from the syndicated banks overseas as the continuation of the negotiation outcome in respect to the London Club, and as the implementation of the comparable treatment principle as demanded by the foreign donor countries which had extended the loans to the Government.

Further, during the Paris Club III meeting, the rescheduling of Indonesia's offshore loans also covered their interest rate payments. In addition, as the implication of the comparable treatment from the agreement reached in Paris Club III meeting, the Government managed to negotiate through the London Club so that the rescheduling of Foreign Commercial Loans (PKLN) covered the principle loans and syndicated loan interests. The forum also agreed on the debt conversion/swap over the Government's offshore loans.